Shrinking budget? Consumers choose less variety when investing or shopping

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When consumer budgets grow or shrink, how do spending habits change? A common view is that people with a budget will spend their money on the same number of products, even when their previous budget was lower or higher. But in order to keep their favorite items, consumers whose budgets have shrunk to a particular amount will opt for less variety than someone whose budget has increased to that same amount, according to a new study in the *Journal of Marketing Research*. Investors beware!

"We call this the budget contraction effect," write authors Kurt A. Carlson (Georgetown University), Jared Wolfe (Long Island University), Simon J. Blanchard (Georgetown University), Joel C. Huber (Duke University), and Dan Ariely (Duke University). "Instead of spreading losses evenly across many items, consumers prefer to focus a shrinking budget on a narrower set of preferred products."

Study participants were asked to imagine that they had won a shopping spree at Costco. They were to distribute spending across nine different products: muffins, bread, M&Ms, Power Bars, apple sauce, ravioli, two kinds of pizza, and cheesecake. They began with a $40 budget and wrote down how much of each product they would buy. They repeated the process with an $80 shopping spree, and finally a $120 spree. The conditions were the same for people in the contracting budget study, except that the first budget was $120, the second was $80, and the final budget was $40.

The authors found that consumers whose budget had shrunk significantly reduced the variety of products they chose to buy, preferring to eliminate some items altogether in order to maintain favorite items at a level they had become used to under the higher budget. This tendency applied not only to grocery items, but to investment and travel decisions as well.

"It is vital to understand the budget contraction effect. During economic downturns, consumers with falling budgets may be tempted to move their money into a smaller number of investments, creating a more risky portfolio. Familiarizing people with the budget contraction effect could help them avoid such dangers and develop a better understanding of how to deal with harsh economic circumstances," conclude the authors.

More information: Kurt A. Carlson, Jared Wolfe, Simon J. Blanchard, Joel C. Huber, and Dan Ariely. "The Budget Contraction Effect: How Contracting Budgets Lead to Less Varied Choice." Forthcoming in the *Journal of Marketing Research*.

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